

Edgar Filing: AMERICAN AMMUNITION INC/FL - Form 10QSB/A

AMERICAN AMMUNITION INC/FL  
Form 10QSB/A  
October 22, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

Form 10-QSB/A

(Mark one)

Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: March 31, 2006

Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-32379

American Ammunition, Inc.

-----  
(Exact name of small business issuer as specified in its charter)

Nevada

91-2021594

-----  
(State of incorporation)

-----  
(IRS Employer ID Number)

3545 NW 71st Street, Miami, FL 33147

-----  
(Address of principal executive offices)

(305) 835-7400

(Issuer's telephone number)

-----  
Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES  NO

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: As of September 17, 2007:, the Transfer Agent's records indicate that there are 28,372,922 shares outstanding. Of these shares, a total of 21,803,335 shares were subject to an escrow agreement referenced in later filings.

Transitional Small Business Disclosure Format (check one): YES  NO

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American Ammunition, Inc.  
Form 10-QSB/A for the Quarter ended March 31, 2006

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PART I - FINANCIAL INFORMATION

ITEM 1 - Financial Statements

The March 31, 2006 financial statements have been restated to account for the derivative liability that was incurred in connection with the common stock conversion features and the warrants issued with certain notes payable.

American Ammunition, Inc. and Subsidiaries  
Consolidated Balance Sheets  
March 31, 2006

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(Unaudited)

|  | (RESTATED)<br>March 31, 2006<br>----- |
|--|---------------------------------------|
| ASSETS   |                                       |
| Current Assets   |                                       |
| Cash on hand and in bank   | \$ 289,712                            |
| Accounts receivable - trade, net of allowance for<br>doubtful accounts of \$12,463                             | 230,234                               |
| Inventory  | 425,337                               |
| Prepaid interest   | 339,253                               |
| Prepaid expenses   | 64,936                                |
|  | -----                                 |
| Total Current Assets   | 1,349,472                             |
|  | -----                                 |
| Property and Equipment - at cost   |                                       |
| Manufacturing equipment  | 8,126,135                             |
| Office furniture and fixtures  | 69,889                                |
| Leasehold improvements   | 190,277                               |
|  | -----                                 |
|  | 8,386,301                             |
| Accumulated depreciation   | (5,608,472)                           |
| Impairment of recoverability of carrying value   | (2,777,829)                           |
|  | -----                                 |
| Net Property and Equipment   | -                                     |
|  | -----                                 |
| Other Assets   |                                       |
| Patents, Trademarks and Noncompetition agreement,<br>net of accumulated amortization of approximately \$78,112 | 197,578                               |
| Loan costs and fees, net of accumulated amortization of approximately \$24,795                                 | 40,455                                |
| Deposits and other   | 83,660                                |
|  | -----                                 |
| Total other assets   | 321,693                               |
|  | -----                                 |
| TOTAL ASSETS   | \$ 1,671,165                          |
|  | =====                                 |

- Continued -

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(RESTATED)  
March 31, 2006  
-----

| LIABILITIES AND STOCKHOLDERS' EQUITY  |                          |
|---|--------------------------|
| Current Liabilities   |                          |
| Notes payable to shareholders   | \$ 975,000               |
| Working capital advance   | 200,000                  |
| Customer deposits   | 188,020                  |
| Accounts payable - trade  | 1,042,892                |
| Accrued salaries and wages  | 253,552                  |
| Accrued interest payable  | 28,361                   |
| Accrued dividends payable   | 39,780                   |
|   | -----                    |
| Total Current Liabilities   | 2,727,605                |
| Long-Term Liabilities   |                          |
| Convertible debenture   | 226,365                  |
| Derivative liability from note conversion features  | 3,284,149                |
|   | -----                    |
| Total Liabilities   | 6,238,119                |
|   | -----                    |
| Commitments and Contingencies   |                          |
| Stockholders' Equity  |                          |
| Preferred stock - \$0.001 par value 20,000,000 shares authorized.<br>1,795,320 shares allocated to Series A 91,700 shares allocated<br>to Series B 1,905,882 shares allocated to Series C<br>200,000 shares allocated to Series E | 2,040                    |
| Common stock - \$0.001 par value. 300,000,000 shares authorized.<br>4,440,714 shares issued and outstanding   | 4,441                    |
| Additional paid-in capital  | 25,654,502               |
| Accumulated other comprehensive loss  | (2,706,397)              |
| Accumulated deficit   | (27,346,540)             |
|   | -----                    |
| Stock subscription receivable   | (4,391,954)<br>(175,000) |
| Total Stockholders' Equity  | (4,566,954)              |
|   | -----                    |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY  | \$ 1,671,165             |
|   | =====                    |

The accompanying notes are an integral part  
of these consolidated financial statements.

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|  | Three months<br>ended<br>March 31, 2006 | Three months<br>ended<br>March 31, 2005 |
|--|---|---|
|  | -----                                   | -----                                   |
| Revenues - net of returns and allowances   | 710,111                                 | \$1,170,317                             |
|  | -----                                   | -----                                   |
| Cost of Sales  |   |   |
| Materials, Direct Labor and other direct costs   | 1,347,081                               | 1,349,331                               |
| Depreciation   | 31,024                                  | 187,249                                 |
|  | -----                                   | -----                                   |
| Total Cost of Sales  | 1,378,105                               | 1,536,580                               |
|  | -----                                   | -----                                   |
| Gross Profit   | (667,994)                               | (366,263)                               |
|  | -----                                   | -----                                   |
| Operating Expenses   |   |   |
| Research and development expenses  | -                                       | 1,732                                   |
| Marketing and selling expenses   | 55,817                                  | 81,106                                  |
| Other operating expenses   | 374,908                                 | 319,561                                 |
| Interest expense   | 150,329                                 | 6,520                                   |
| Depreciation expense   | -                                       | 1,317                                   |
| Amortization expense   | 13,785                                  | 13,785                                  |
|  | -----                                   | -----                                   |
| Total Operating Expenses   | 594,839                                 | 424,021                                 |
|  | -----                                   | -----                                   |
| Loss from Operations   | (1,262,833)                             | (790,284)                               |
| Other Income (Expense)   | 41,557                                  | 4,240                                   |
|  | -----                                   | -----                                   |
| Loss before Income Taxes   | (1,221,276)                             | (786,044)                               |
| Provision for Income Taxes   | -                                       | -                                       |
|  | -----                                   | -----                                   |
| Net Loss   | (1,221,276)                             | (786,044)                               |
|  | -----                                   | -----                                   |
| Other Comprehensive Income   |   |   |
| Change in derivative related to note conversion  | (2,748,947)                             | -                                       |
|  | -----                                   | -----                                   |
| Comprehensive Loss   | \$ (3,970,223)                          | \$ (786,044)                            |
|  | =====                                   | =====                                   |
| Preferred Stock Dividends  | (12,050)                                | (27,221)                                |
|  | -----                                   | -----                                   |
| Net Loss available to Common Shareholders  | \$ (1,233,326)                          | \$ (813,265)                            |
|  | =====                                   | =====                                   |
| Loss per weighted-average share of common stock outstanding,<br>computed on net loss available to common shareholders -<br>basic and fully diluted | \$ (0.29)                               | \$ (0.22)                               |
|  | =====                                   | =====                                   |
| Weighted-average number of<br>common shares outstanding  | 4,270,491                               | 3,744,419                               |
|  | =====                                   | =====                                   |

The accompanying notes are an integral part of these consolidated financial statements.

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American Ammunition, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows  
 Three months ended March 31, 2006 and 2005  
 (Unaudited)

|   | (RESTATED)<br>Three months<br>ended<br>March 31, 2006 | M     |
|---|---|-------|
| Cash flows from operating activities  |   |       |
| Net loss for the period   | \$ (1,221,276)  | \$    |
| Adjustments to reconcile net loss to<br>net cash provided by operating activities |   |       |
| Depreciation and amortization   | 171,377   |       |
| Expenses paid with common stock   | 18,325  |       |
| (Increase) Decrease in  |   |       |
| Accounts receivable   | 341,193   |       |
| Inventory   | 134,753   |       |
| Prepaid expenses, deposits and other  | (8,147)   |       |
| Increase (Decrease) in  |   |       |
| Accounts payable - trade  | 196,275   |       |
| Other accrued expenses  | (17,813)  |       |
|   | -----   |       |
| Net cash (used in) operating activities   | (385,313)   | ----- |
| Cash flows from investing activities  |   |       |
| Purchase of property and equipment  | (31,025)  |       |
|   | -----   |       |
| Net cash (used in) investing activities   | (31,025)  | ----- |
| Cash flows from financing activities  |   |       |
| Cash received on working capital advance  | 50,000  |       |
| Cash received from sale of preferred stock  | 250,000   |       |
| Cash paid to acquire capital  | (50,000)  |       |
|   | -----   |       |
| Net cash provided by financing activities   | 275,000   | ----- |
| Increase (Decrease) in Cash   | (141,338)   |       |
| Cash at beginning of period   | 431,050   |       |
|   | -----   |       |
| Cash at end of period   | \$ 289,712  | \$    |
| Supplemental disclosure of interest and income taxes paid                         |   |       |
| Interest paid for the period  | \$ 4,525  | \$    |
|   | =====   |       |
| Income taxes paid for the period  | \$ -  | \$    |
|   | =====   |       |
| Supplemental disclosure of non-cash investing and financing activities            |   |       |
| Issuance of common stock to pay accrued interest                                  | \$ 17,261   | \$    |
|   | =====   |       |

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The accompanying notes are an integral part of these consolidated financial statements.

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### American Ammunition, Inc. and Subsidiaries Notes to Restated Consolidated Financial Statements March 31, 2006 and 2005

#### Note A - Organization and Description of Business

American Ammunition, Inc. (AAI or Company) was incorporated on February 1, 2000 in accordance with the Laws of the State of California. The Company functions as a holding company providing management oversight services to its wholly-owned operating subsidiaries; F&F Equipment, Inc. and Industrial Plating Enterprise Co.

F&F Equipment, Inc. (F&F) was incorporated on October 4, 1983 in accordance with the Laws of the State of Florida. F&F is engaged in the design, manufacture and international sales of small arms ammunition. F&F has conducted its business operations under the assumed name of "American Ammunition" since its inception.

Industrial Plating Enterprise Co. (IPE), which was incorporated and commenced production on June 14, 2002. IPE is a fully licensed and approved state of the art electrochemical metallization facility for processing the Company's line of small arms projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques. The facility meets or exceeds all current environmental requirements and enjoys the "conditionally exempt small quantity generator" status for State and Federal regulations. All activities of IPE since its inception have been dedicated to the needs and demands of F&F.

On January 9, 2006, by written consent in lieu of meeting, a majority of the Company's stockholders approved a recommendation by the Company's Board of Directors to effect a one share for twenty shares reverse stock split of our common stock, par value \$.001 per share, with fractional shares rounded up to the nearest whole share. The reverse split became effective on that date. As a result of the reverse split, the total number of issued and outstanding shares of the Company's common stock decreased from 92,576,839 to 4,629,381 shares, after giving effect to rounding for fractional shares. The effect of this action is reflected in the Company's financial statements as of the first day of the first period presented.

#### Note B - Preparation of Financial Statements

The Company and its subsidiaries follow the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and have adopted a year-end of December 31 for all entities.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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Management further acknowledges that it is solely responsible for adopting sound accounting practices, establishing and maintaining a system of internal accounting control and preventing and detecting fraud. The Company's system of internal accounting control is designed to assure, among other items, that 1) recorded transactions are valid; 2) valid transactions are recorded; and 3) transactions are recorded in the proper period in a timely manner to produce financial statements which present fairly the financial condition, results of operations and cash flows of the Company for the respective periods being presented

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### American Ammunition, Inc. and Subsidiaries Notes to Restated Consolidated Financial Statements - Continued March 31, 2006 and 2005

#### Note B - Preparation of Financial Statements - Continued

During interim periods, the Company follows the accounting policies set forth in its annual audited financial statements filed with the U. S. Securities and Exchange Commission on its Annual Report on Form 10-KSB for the year ended December 31, 2005. The information presented within these interim financial statements may not include all disclosures required by generally accepted accounting principles and the users of financial information provided for interim periods should refer to the annual financial information and footnotes when reviewing the interim financial results presented herein.

In the opinion of management, the accompanying interim financial statements, prepared in accordance with the U. S. Securities and Exchange Commission's instructions for Form 10-QSB, are unaudited and contain all material adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial condition, results of operations and cash flows of the Company for the respective interim periods presented. The current period results of operations are not necessarily indicative of results which ultimately will be reported for the full fiscal year ending December 31, 2005.

For segment reporting purposes, the Company operated in only one industry segment during the periods represented in the accompanying financial statements and makes all operating decisions and allocates resources based on the best benefit to the Company as a whole.

The accompanying consolidated financial statements contain the accounts of American Ammunition, Inc. and its wholly-owned subsidiaries, F&F Equipment, Inc. and Industrial Plating Enterprise Co. All significant intercompany transactions have been eliminated. The consolidated entities are collectively referred to as "Company".

#### Note C - Summary of Significant Accounting Policies

##### 1. Cash and cash equivalents

For Statement of Cash Flows purposes, the Company considers all cash on hand and in banks, certificates of deposit and other highly-liquid investments with maturities of three months or less, when purchased, to be cash and cash equivalents.



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Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies.

### 2. Accounts receivable and Revenue Recognition

In the normal course of business, the Company extends unsecured credit to virtually all of its customers which are located throughout the United States. Because of the credit risk involved, management has provided an allowance for doubtful accounts which reflects its opinion of amounts which will eventually become uncollectible. In the event of complete non-performance, the maximum exposure to the Company is the recorded amount of trade accounts receivable shown on the balance sheet at the date of non-performance.

The Company ships all product on an FOB-Plant, "as-is" basis. Accordingly, revenue is recognized by the Company at the point at which an order is shipped at a fixed price, collection is reasonably assured and the Company has no remaining performance obligations related to the sale. The Company sells all products with "no right of return" by the purchaser for any factor other than defects in the product's production.

In limited situations, the Company may elect to accept product returns from customers on a case-by-case basis to offset unpaid accounts receivable. These situations are a "last case" scenario and are initiated by senior management through negotiations with the respective customer.

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

### Note C - Summary of Significant Accounting Policies - Continued

#### 3. Inventory

Inventory consists of raw materials, work-in-process and finished goods related to the production and sale of small arms ammunition. Inventory is valued at the lower of cost or market using the first-in, first-out method.

#### 4. Property, plant and equipment

Property and equipment are recorded at historical cost. These costs are depreciated over the estimated useful lives of the individual assets using the straight-line method, generally three to ten years.

Gains and losses from disposition of property and equipment are recognized as incurred and are included in operations.

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company follows the policy of evaluating all property and equipment as of the end of each reporting quarter. At December 31, 2005, pursuant to the requirements of this accounting standard, management recorded an impairment against the future recoverability of these assets of approximately

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\$2,777,829.

5. Income Taxes

The Company uses the asset and liability method of accounting for income taxes. At March 31, 2006 and 2005, the deferred tax asset and deferred tax liability accounts, as recorded when material to the financial statements, are entirely the result of temporary differences. Temporary differences represent differences in the recognition of assets and liabilities for tax and financial reporting purposes, primarily accumulated depreciation and amortization, allowance for doubtful accounts and vacation accruals.

As of March 31, 2006 and 2005, respectively, the deferred tax asset related to the Company's net operating loss carryforward is fully reserved. In the event that these carryforwards were not fully utilized, these carryforwards began to expire in 2005.

6. Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing the net income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the respective period presented in our accompanying financial statements.

Fully diluted earnings (loss) per share is computed similar to basic income (loss) per share except that the denominator is increased to include the number of common stock equivalents (primarily outstanding options and warrants).

Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method, at either the beginning of the respective period presented or the date of issuance, whichever is later, and only if the common stock equivalents are considered dilutive based upon the Company's net income (loss) position at the calculation date.

As of March 31, 2006 and 2005, and subsequent thereto, the Company had no options outstanding. The outstanding warrants and convertible preferred stock and mandatorily convertible debentures are anti-dilutive due to the Company's net operating loss position.

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

Note C - Summary of Significant Accounting Policies - Continued

7. Advertising costs

The Company does not conduct any direct response advertising activities. For non-direct response advertising, the Company charges the costs of these efforts to operations at the first time the related advertising is published.

Note D - Correction of an Error

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On August 22, 2007, our management concluded that the financial statements included in our Forms 10-QSB for June and September 2005, the calendar year 2006 and for the period ending March 31, 2007, and the Forms 10-KSB for the periods ending December 31, 2005 and December 31, 2006, all of which have been previously filed with the Securities and Exchange Commission, need to be restated, due to the failure to include the beneficial conversion feature discount on unsecured convertible indebtedness.

Management discovered such changes needed to be made after consulting with Pollard-Kelley Auditing Services, our independent registered public accounting firm as of June 26, 2007, who have concurred with management as to the reexamination of the above mentioned issues.

The Company has entered into certain notes payable to shareholders and other affiliated parties with embedded conversion features and warrant issues. The appropriate accounting is governed by EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The fair value is determined to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis.

Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

Note D - Correction of an Error - Continued

The errors discovered by management relate directly to the accounting for and recording various conversion features and warrants as follows:

|   | Three months<br>ended<br>March 31,<br>2006<br>----- |
|---|---|
| Net Loss, as previously restated and reported   | \$ (1,108,192)                                      |
| Effect of the correction of an error<br>(Increase) Decrease in Net Loss by financial statement line item:   |   |
| Operating expenses: Interest expense recognized<br>from beneficial conversion discount feature on<br>notes payable to shareholders and other affiliates | <br><br><br>(113,084)                               |

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|   |                |
|---|----------------|
| Total effect of changes on Loss from Operations and Net Loss      | (113,084)      |
| Net Loss, as restated   | \$ (1,221,276) |
| Net loss available to common stockholders, as previously reported | \$ (1,120,242) |
| Effect of the correction of an error                              |                |
| Total effect as shown above                                       | (113,084)      |
| Net Loss available to common stockholders, as restated            | \$ (1,233,326) |
| Earnings per share, as previously reported                        | \$ (0.26)      |
| Total effect of changes   | (0.03)         |
| Earnings per share, as restated                                   | \$ (0.29)      |

In light of the restatements to the financial statements disclosed above, caused, in part, by a failure in the Company's internal control over financing reporting due to the limitations in the Company's accounting resources to identify and react in a timely manner to non-routine, complex and/or transactions originated by other parties on the Company's behalf, as well as gaining an adequate understanding of the disclosure requirements relating to these types of transactions, we feel that the existing controls and procedures were and remain effective. Because of said controls, which resulted in the review, discovery and disclosure by amendment of filings to adequately disclose required information, management also concludes that by requiring supplemental reviews of financing transactions that its existing controls and procedures will be more effective.

American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

Note E - Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable and notes payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions.

Interest rate risk is the risk that the Company's earnings are subject to fluctuations in interest rates on either investments or on debt and is fully dependent upon the volatility of these rates. The Company does not use derivative instruments to moderate its exposure to interest rate risk, if any.

Financial risk is the risk that the Company's earnings are subject to fluctuations in interest rates or foreign exchange rates and are fully dependent upon the volatility of these rates. The company does not use derivative instruments to moderate its exposure to financial risk, if any.

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Note F - Inventory

As of March 31, 2006, inventory, as valued using the lower-of-cost or market, consisted of the following components:

|                 | March 31,<br>2006 |
|-----------------|-------------------|
|                 | -----             |
| Raw materials   | \$ 359,157        |
| Work in process | 58,717            |
| Finished goods  | 7,463             |
|                 | -----             |
| Totals          | \$ 425,337        |
|                 | =====             |

Note G - Property and Equipment

Property and equipment consist of the following components:

|  | March 31,<br>2006 | Estimated<br>useful life |
|--|-------------------|--------------------------|
|  | -----             |                          |
| Manufacturing equipment                        | \$ 8,126,135      | 3-10 years               |
| Office furniture and fixtures                  | 69,889            | 3- 7 years               |
| Leasehold improvements                         | 190,277           | 8-20 years               |
|  | -----             |                          |
|  | 8,386,301         |                          |
| Accumulated depreciation                       | (5,608,472)       |                          |
| Impairment of recoverability of carrying value | (2,777,829)       |                          |
|  | -----             |                          |
| Net property and equipment                     | \$ -              |                          |
|  | =====             |                          |

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

Note G - Property and Equipment - Continued

Total depreciation expense charged to operations for the three month periods ended March 31, 2006 and 2005, respectively, was approximately \$31,024 and \$188,566.

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company follows the policy of evaluating all property and equipment as of the end of each reporting quarter. At December 31, 2005, pursuant to the requirements of this accounting standard, management recorded an impairment for the future recoverability of these assets of approximately \$2,777,829.

Note H - Loans from Shareholders

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March 31, March 31,  
2006 2005  
-----

Notes payable to three separate shareholders. Interest at 8.0%, payable monthly. Principal due at maturity on December 31, 2006. Shareholder/lender has the option to convert the principal amount into common stock of the Company at the lesser of 66-2/3% of the average closing bid and ask price on the date of conversion or \$0.07 per share. Each note is unsecured.

\$ 975,000 \$ -  
=====

Note I - Convertible Debenture

The Company entered into a Securities Purchase Agreement with La Jolla Cove Investors, Inc. ("La Jolla") on October 4, 2002 for the sale of (i) \$250,000 in convertible debentures and (ii) warrants to buy 30,000,000 shares of our common stock. On March 13, 2003 and May 6, 2003, La Jolla advanced an aggregate of \$350,000 to our company which such funding was allocated towards the principal balance of our convertible debentures.

As of March 31, 2006, the outstanding balance on the convertible debenture is approximately \$226,365 and we have approximately 2,263,650 warrants outstanding. A recap of the debenture activity is as follows:

|   | Debenture<br>(in dollars) | Warrant<br>(in shares) |
|---|---------------------------|------------------------|
|   | -----                     | -----                  |
| Initial amount                            | \$ 600,000                | 6,000,000              |
| 2003 redemptions                          | (208,635)                 | (2,086,350)            |
| 2004 redemptions                          | (125,000)                 | (1,250,000)            |
| 2005 redemptions                          | (40,000)                  | (400,000)              |
|   | -----                     | -----                  |
| Balances outstanding<br>at March 31, 2006 | \$ 226,365                | 2,263,650              |
|   | =====                     | =====                  |

The debentures bear interest at 8%, mature on June 31 [sic], 2007, and are convertible into the Company's common stock, at the selling stockholder's option. The convertible debentures are convertible into the number of the Company's shares of common stock equal to the principal amount of the debentures being converted multiplied by 11, less the product of the conversion price

Note I - Convertible Debenture - Continued

multiplied by 10 times the dollar amount of the debenture. The conversion price for the convertible debentures is the lesser of (i) \$1.00 or (ii) seventy six percent of the average of the five lowest volume weighted average prices during

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the twenty (20) trading days prior to the conversion. Accordingly, there is in fact no limit on the number of shares into which the debenture may be converted. However, in the event that our market price is less than \$0.30 per share, the Company will have the option to prepay the debenture at 125% rather than have the debenture converted. In addition, the selling stockholder is obligated to exercise the warrant concurrently with the submission of a conversion notice by the selling stockholder. As of March 31, 2006, the warrant is exercisable into 2,263,650 shares of common stock at an exercise price of \$1.00 per share.

In December 2004, we entered into an addendum to the convertible debenture and warrant whereby the Company agreed to the following:

- \* the discount multiplier was reduced from eighty percent to seventy six percent;
- \* within five business days after this registration statement being declared effective, La Jolla is required to submit a debenture conversion in the amount of \$10,000 and every ten business days thereafter La Jolla shall submit three additional debenture conversion in the amount of \$10,000 each;
- \* within five business days after this registration statement being declared effective, La Jolla shall wire \$400,000 to us as a prepayment towards the exercise of its warrant; and
- \* immediately following the sale of all shares held by La Jolla in connection with the debenture conversions in the aggregate amount of \$40,000, La Jolla shall wire \$275,000 to us as a prepayment towards the exercise of its warrant and shall submit a debenture conversion in the amount of \$6,250 on the first business day of each month until the debenture is no longer outstanding.

In May 2005, we entered into an additional addendum to the convertible debenture and warrant whereby the Company agreed to the following:

- \* The Company shall deposit 4,000,000 unregistered shares in the name of LaJolla with the Company's Escrow Agent and, upon confirmation of receipt, LaJolla will wire the Company \$150,000 as an advance on the \$400,000 amount that LaJolla was obligated to fund pursuant to the December 2004 Addendum. In the event that the Company's Registration Statement was not declared effective within nine (9) months of the date of this Addendum, the 4,000,000 shares in escrow will be released to LaJolla and sold by LaJolla pursuant to Rule 144. If LaJolla sells these shares for net sales proceeds of more than \$150,000 (without interest accruing on this amount), the excess over \$150,000 will be refunded to the Company.
- \* The maturity date of the convertible debenture and warrant was extended to June 31, [sic], 2007.
- \* All other terms and conditions remain in full force and effect.

LaJolla has contractually agreed to restrict its ability to convert or exercise its warrants and receive shares of our common stock such that the number of shares of common stock held by them and their affiliates after such conversion or exercise does exceed 4.9% of the then issued and outstanding shares of common stock.

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### Note I - Convertible Debenture - Continued

Due to the contractually agreed mandatory conversion of this Debenture, the Company has reflected this transaction in its balance sheet as a "mezzanine" level debt obligation on its balance sheet, between "Total Liabilities" and "Stockholders' Equity". Upon the respective mandatory conversion, the Company will relieve the respective portion of the Debenture and the any related accrued, but unpaid interest, and credit this amount to the respective "common stock" and "additional paid-in capital" accounts in the stockholder's equity section for the par value and excess amount over the par value of the respective shares issued.

As the warrant is non-detachable from the Debenture and requires simultaneous exercise upon conversion of the Debenture, no value was assigned to the issued warrant. Upon exercise of the warrant, the Company will record the issuance of the underlying shares as a new issuance of common stock on the date of each respective exercise.

On various dates through December 31, 2003, the Debenture Holder elected to convert an aggregate \$208,635, through 24 separate transactions, in outstanding Debenture principal into restricted, unregistered common stock. This election caused the Company to issue 4,561,753 shares of restricted, unregistered common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 2,086,350 shares of the Company's restricted, unregistered common stock for gross proceeds of \$2,086,350.

On various dates between January 1, 2004 and December 31, 2004, the Debenture Holder elected to convert an aggregate \$125,000, through 6 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 4,150,000 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 1,250,000 shares of the Company's common stock for gross proceeds of \$1,250,000. As of December 31, 2004, an aggregate of 1,000,000 shares of the Company's common stock have been issued by the Company and are being held in escrow by the Company's counsel pending receipt of the final \$175,000 from the Debenture Holder. As of March 31, 2006, this amount remains unpaid.

On various dates between June 28, 2005 and August 10, 2005, the Debenture Holder elected to convert an aggregate \$40,000, through 4 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 5,872,048 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 400,000 shares of the Company's common stock for gross proceeds of \$400,000.



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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

### Note J - Derivative Liability arising from Warrants

The Company accounts for debt with embedded conversion features and warrant issues in accordance with EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The Company determines the fair value to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis.

Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

### Note K - Preferred Stock Transactions

Preferred stock consists of the following as of March 31, 2006, respectively:

|   | March 31, 2006 |              |
|---|----------------|--------------|
|   | # shares       | value        |
| Series A Cumulative Convertible Preferred Stock | 12,000         | \$ 60,000    |
| Series B Cumulative Convertible Preferred Stock | 73,360         | 366,800      |
| Series C Convertible Preferred Stock            | 1,905,000      | 324,000      |
| Series E 8% Convertible Preferred Stock         | 50,000         | 250,000      |
|   | -----          | -----        |
|   | 2,040,360      | \$ 1,000,800 |
|   | =====          | =====        |

#### Series A Convertible Preferred Stock

In September, October and November 2001, the Company sold an aggregate 222,600 shares of \$5.00 Series A Convertible Preferred Stock (Series A Preferred Stock) for total proceeds of approximately \$1,113,000 through a Private Placement Memorandum. The Series A Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series A Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events. In December 2001, at the request of the holders of the Series A Preferred Stock, the Company and the individual holders modified the holding period for conversion to allow for conversion in December 2001.

American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

Note K - Preferred Stock Transactions - Continued

Series A Convertible Preferred Stock - continued

In September 2001, the Company's principal stockholder converted approximately \$4,007,327 of unsecured debt and approximately \$3,546,273 of cumulative and unpaid accrued interest into 1,510,710 shares of Series A Preferred Stock.

In September 2001, a creditor of the Company agreed to convert approximately \$10,000 of trade accounts payable into 2,000 shares of Series A Preferred Stock.

In December 2001, concurrent with a modification in the holding period prior to conversion, certain holders of the Series A Preferred Stock orally notified the Company of their intent to exercise the conversion features on 1,749,720 issued and outstanding shares of Series A Preferred Stock into 19,246,920 shares of common stock prior to December 31, 2001. Due to the timing of the requisite documentation, the clerical activities related to this conversion were not completed until February 2002.

In conjunction with the Series A Preferred Stock, certain shares were sold after the Company's common stock was approved for trading by the National Association of Securities Dealers on the OTC Bulletin Board in October 2001. The shares of Series A Preferred Stock sold subsequent to this date had an equivalent per share value of common stock below the ending quoted market price of the Company's common stock on their respective issue dates. This difference created a Beneficial Conversion Feature Discount of approximately \$1,207,993. This discount was then amortized over the unexpired time period between the date of issue of the eligible shares and the eligible conversion date, as amended. All of the shares sold subsequent to the initial trading date were converted in December 2001 and, accordingly, the approximate \$1,207,993 in Beneficial Conversion Feature Discount was fully amortized to operations.

In December 2002, a holder of 5,000 shares of Series A Preferred Stock exercised his conversion rights and converted these shares of Series A Preferred Stock into 55,000 shares of restricted, unregistered common stock.

In January 2003, three separate holders of 9,000 shares of Series A Preferred Stock exercised their conversion rights and converted these shares of Series A Preferred stock into 99,000 shares of restricted, unregistered common stock.

Series B Convertible Preferred Stock

In May 2003, the Company sold an aggregate 91,700 shares of \$5.00 Series B Convertible Preferred Stock (Series B Preferred Stock) for total proceeds of approximately \$458,500 through a separate Private Placement Memorandum. The Series B Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series B Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events.

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In September and December 2004, respectively, the Holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 18,340 shares of Series B Preferred Stock for 1,336,200 shares of restricted, unregistered common stock.

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

### Note K - Preferred Stock Transactions - Continued

#### Series C Convertible Preferred Stock

In November 2004, the Company sold 1,905,882 shares of Series C Convertible Preferred Stock to an existing shareholder and officer of the Company in a private transaction pursuant to Section (4)2 of the Securities Act of 1933 for gross proceeds of approximately \$324,000. No underwriter was used in conjunction with this transaction.

The Series C Convertible Preferred Stock provides for dividends at a rate of 4.0% per annum, to be declared and paid monthly in either cash or stock at the discretion of the Company.

Each share of Series C Preferred Stock is convertible at a rate of \$0.18 per share into 1,800,000 shares of the Company's common stock at any time at the option of the holder, subject to adjustments for customary anti-dilution events.

#### Series E 8% Convertible Preferred Stock

On March 1, 2006, the Company issued a Private Placement Memorandum offering up to 200,000 shares of 8% Convertible Preferred Stock at an offering price of \$5.00 per share on a "best efforts" basis through an unrelated placement agent.

The Series E 8% Convertible Preferred Stock provides for cumulative dividends at the rate of 8% per year, payable quarterly, 50% in cash and 50% in shares or 100% in cash at the Company's election. In the event the Company elects to pay such dividends in shares of the Company's Common Stock, the number of shares to be issued shall be based on the average of the closing prices of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the Company's Common Stock is then traded) for the 10 consecutive trading days preceding the record date for each such dividend, with such record date being the 14th day preceding the end of each calendar quarter.

Each share of Series E Convertible Preferred Stock shall be convertible into shares of the Company's Common Stock at any time after March 1, 2007. The number of shares to be issued on a conversion shall be based on 80% of the average closing price of the Common Stock of the Company; as reported on the NASDAQ OTC Bulletin Board (or such other market on which such stock is traded) for ten (!0) consecutive trading days preceding the date the Company received notice of such conversion. Subject to certain restrictions, the Series E 8% Convertible Preferred Stock shall automatically convert into shares of the Company's Common Stock upon any of the following events: (I) the sale by the Company of all or substantially all of its assets; (ii) the consummation of a merger or a consolidation in which the Company is not the survivor; or (iii) the sale or

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exchange of all or substantially all of the outstanding shares of the Company's common stock (including by way of merger, consolidation, or other similar action).

In the event of the liquidation, dissolution or winding up of the Company, the holders of Series E Convertible Preferred Stock shall have a liquidation preference over holders of common stock and shares junior to the Series E 8% Convertible Preferred Stock equal to \$5.50 per share. Additionally, the Company

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

Note K - Preferred Stock Transactions - Continued

Series E 8% Convertible Preferred Stock - continued

shall not impose or allow any additional liens on its existing fixed assets in excess of \$1,000,000; provided that at such time as total gross proceeds from the offering equal or exceed \$2,000,000, the Company shall satisfy such existing liens on its existing fixed assets and shall not impose or allow any additional liens on its existing fixed assets unless subordinated to the interest of the Series E 8% Convertible Preferred Stock, with such preference on the fixed assets equal to the fixed asset value, as determined in accordance with the United States Generally Accepted Accounting Principles ("GAAP"), of 150% of the stated value of the aggregate of the outstanding shares of Series E Convertible Preferred Stock except for fixed assets of the Company that were otherwise purchased pursuant to a security interest.

The Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the Company, for cash in the amount of \$5.50 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate, at any time after March 1, 2007, or in the event the closing sale price of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the Company's Common Stock is then traded), is greater than or equal to \$7.00 after March 1, 2007 for any consecutive five trading days. In addition, the Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the holder, at any time for shares of the Company's Common Stock in accordance with the Conversion Rate. At any time after March 1, 2007, at the option of the holder, the Series E 8% Convertible Preferred Stock shall be redeemable for cash in the amount of \$5.10 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate. After such date, if redemption is for cash, shares will be redeemed at the rate of 1/10 of such aggregate shares per quarterly period for any 10 consecutive quarters commencing after March 1, 2007. Any redemption by either the Company or the holder shall be subject to 15 days written notice.

The Company warrants and agrees that if, at any time within the period commencing on the date of the final closing of the Offering and expiring on the 5th anniversary of the date thereof, the Company should file a registration statement with the SEC under the Securities Act (other than in connection with a merger or other business combination transaction or pursuant to Form S-8), it will give written notice at least 30 calendar days prior to the filing of each

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such registration statement to the holders of the Series E 8% Convertible Preferred Stock and the holders of the shares of the Common Stock issued upon the conversion or redemption of the shares of Series E Convertible Preferred Stock, or their permitted assigns (Holders) of its intention to do so. If the Holders notify the Company within 30 calendar days after receipt of any such notice of its or their desire to include any such shares of Common Stock issued or issuable upon the conversion or redemption of the Series E 8% Convertible Preferred Stock in such proposed registration statement, the Company shall use its "best efforts" to have any such shares of Common Stock is issued or issuable upon the conversion or redemption of the Series E 8% Convertible Preferred Stock registered under such registration statement.

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

Note K - Preferred Stock Transactions - Continued

Series E 8% Convertible Preferred Stock - continued

Notwithstanding the foregoing, the Company shall have the right at any time after it shall have given written notice (irrespective of whether a written request for inclusion of any such securities shall have been made) to elect not to file any such proposed registration statement, or to withdraw the same after the filing but prior to the effective date thereof. If the managing underwriter of an offering to which the above "piggyback registration rights" apply, in good faith and for valid business reasons, objects to such rights, such objection shall preclude such inclusion. All expenses incurred by the Company in registration of the shares of Common Stock issued or issuable upon the conversion or redemption of The Series E 8% Convertible Preferred Stock, including with out limitation all registration and filing fees, listing fees, printing expenses, fees and disbursements of all independent accounts, or counsel for the Company and the expense of any special audits incident to or required by any such registration and the expenses of complying with the securities or blue sky laws of any jurisdiction shall be paid by the Company.

The Company has agreed to pay the Placement Agent a cash commission equal to 10% of the aggregate Purchase Price of the shares of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Fee). The Company shall also pay the Placement Agent reasonable expenses associated with the Offering, which expenses shall not exceed \$50,000 (Expense Allowance). In addition, the Company shall issue to the Placement Agent 500 warrants for each \$50,000 of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Warrants), each warrant entitling the holder to purchase 1 share of the Company's Common Stock at an exercise price of \$0.90 per share exercisable at any time for a period of 3 years from date of issuance.

Upon completion of the Maximum Offering, the Company will receive net proceeds of approximately \$900,000.00. The Company intends to use the net proceeds for potential acquisitions, working capital, general corporate purposes and repayment of outstanding debt.

The Company and the Placement Agent shall have discretion to increase the Maximum Offering to \$2,000,000.00, without notice to investors.

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As of March 31, 2006, the Company has sold 50,000 shares in a single transaction under this Private Placement Memorandum and has received the gross sales proceeds of \$250,000 and has paid \$25,000 (10%) to the Placement Agent for the fee due on this transaction.

### Note L - Common Stock Transactions

On January 9, 2006, by written consent in lieu of meeting, a majority of the Company's stockholders approved a recommendation by the Company's Board of Directors to effect a one share for twenty shares (1 for 20) reverse stock split of our common stock, par value \$.001 per share, with fractional shares rounded up to the nearest whole share. The reverse split became effective on that date. As a result of the reverse split, the total number of issued and outstanding shares of the Company's common stock decreased from 92,576,839 to 4,629,381 shares, after giving effect to rounding for fractional shares. The effect of this action is reflected in the Company's financial statements as of the first day of the first period presented.

In conjunction with the above discussed reverse stock split, all share references in the following paragraphs reflect the January 9, 2006 reverse split action.

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American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

### Note L - Common Stock Transactions - Continued

#### Calendar 2005 Transactions

On various dates between June 28, 2005 and August 10, 2005, the Debenture Holder elected to convert an aggregate \$40,000, through 4 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 293,602 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 400,000 shares of the Company's common stock for gross proceeds of \$400,000.

In September and December 2004, respectively, the Holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 18,340 shares of Series B Preferred Stock for 66,810 shares of restricted, unregistered common stock.

In July 2005, the Company issued approximately 8,333 shares of unregistered, restricted common stock to Paul Goebel, the Company's Director of Domestic Sales, as an employee bonus. These shares were valued at approximately \$17,166, which approximated the market value of the shares on the transaction date. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In February, August, September and December 2005, the Company issued an aggregate 23,615 shares of restricted, unregistered common stock in payment of

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approximately \$44,124 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarters ended December 31, 2004, March 31, 2005, June 30, 2005, September 30, 2005 and December 31, 2005, respectively. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In August, November and December 2005, respectfully, the Company issued an aggregate 37,500 shares of restricted, unregistered common stock to an existing shareholder as payment of various fees and costs associated with the funding of approximately \$875,000 short-term working capital loans to the Company. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

### Calendar 2006 Transactions

In February 2006, the Company issued approximately 41,666 shares of unregistered, restricted common stock to Paul Goebel, the Company's Director of Domestic Sales, as an employee bonus. These shares were valued at approximately \$17,500, which approximated the market value of the shares on the transaction date. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In February 2006, the Company issued approximately 226,065 shares of restricted, unregistered common stock, valued at approximately \$18,325, to an existing shareholder as for payment of accrued interest associated with approximately \$875,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

American Ammunition, Inc. and Subsidiaries  
Notes to Restated Consolidated Financial Statements - Continued  
March 31, 2006 and 2005

### Note M - Rental Commitments

The Company leases its corporate office and manufacturing facility from its controlling stockholder under a long-term operating lease agreement. The lease requires a monthly payment of approximately \$5,735, including applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on December 1, 2009 and contains a clause that upon expiration, the Company and the controlling shareholder shall renegotiate the annual rental amount.

The Company's subsidiary, IPE, leases it's manufacturing facility from an unrelated third-party under a long-term operating lease agreement. This lease is for a period of five (5) years and requires graduated monthly payments, changing on the lease anniversary date, ranging from approximately \$1,751 to \$1,914, plus the applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on February 28, 2007 and may be renewed for an additional five (5) year term at a rental rate of approximately \$1,971, plus applicable sales taxes for the first renewal year and 3.0% increase on each

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succeeding anniversary date. Total rent expense under this lease was approximately \$20,752 and \$16,622, respectively, for each of the years ended December 31, 2004 and 2003.

In May 2004, the Company entered into a long-term lease agreement for a warehouse facility adjacent to the Company's primary office and manufacturing facility. This lease is for a period of two (2) years and requires payments of approximately \$6,206 per month for the first 12 months and approximately \$6,393 for the second 12 months, plus applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. This lease expires on May 31, 2006. Further, the Company is responsible for any incremental real estate taxes and property insurance in excess of the amounts incurred by the landlord for the calendar year immediately preceding the execution of the lease.

Future minimum rental payments on the above leases are as follows:

| Year ended<br>December 31,<br>----- | Amount<br>-----     |
|-------------------------------------|---------------------|
| 2006                                | \$ 117,244          |
| 2007                                | 72,643              |
| 2008                                | 68,815              |
| 2007                                | 68,815              |
|                                     | -----               |
| Totals                              | \$ 327,517<br>===== |

For the respective years ended December 31, 2005 and 2004, the Company paid an aggregate of \$158,947 and \$131,804 in rent under these three lease agreements.

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The components of income tax (benefit) expense for the three month periods ended March 31, 2006 and 2005, respectively, are as follows:

|          | Three months<br>ended<br>March 31,<br>2006 | Three months<br>ended<br>March 31,<br>2005 |
|----------|--|--|
|          | -----                                      | -----                                      |
| Federal: |  |  |
| Current  | \$ -                                       | \$ -                                       |
| Deferred | -  | -  |
|          | -----                                      | -----                                      |
|          | -  | -  |
|          | -----                                      | -----                                      |
| State:   |  |  |
| Current  | -  | -  |
| Deferred | -  | -  |
|          | -----                                      | -----                                      |
|          | -  | -  |
|          | -----                                      | -----                                      |
| Total    | \$ -                                       | \$ -                                       |
|          | =====                                      | =====                                      |

As of December 31, 2005, the Company has a net operating loss carryforward of approximately \$12,000,000 to offset future taxable income. Subject to current regulations, components of this carryforward began to expire in 2005. The amount and availability of the net operating loss carryforwards may be subject to limitations set forth by the Internal Revenue Code. Factors such as the number of shares ultimately issued within a three year look-back period; whether there is a deemed more than 50 percent change in control; the applicable long-term tax exempt bond rate; continuity of historical business; and subsequent income of the Company all enter into the annual computation of allowable annual utilization of the carryforwards.

The Company's income tax expense (benefit) for the three month periods ended March 31, 2006 and 2005, respectively, differed from the statutory federal rate of 34 percent as follows:

|  | Three months<br>ended<br>March 31,<br>2006 | Three months<br>ended<br>March 31,<br>2005 |
|--|--|--|
|  | -----                                      | -----                                      |
| Statutory rate applied to loss before income taxes                           | \$ (414, 800)                              | \$ (267,000)                               |
| Increase (decrease) in income taxes resulting from:                          |  |  |
| State income taxes   | -  | -  |
| Imputed interest on derivative liability from warrants and convertible notes | 38,000                                     | -  |
| Other, including reserve for deferred tax asset                              | 376,800                                    | 267,000                                    |
|  | -----                                      | -----                                      |
| Income tax expense   | \$ -                                       | \$ -                                       |
|  | =====                                      | =====                                      |

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Note N - Income Taxes - Continued

Temporary differences, consisting primarily of the net operating loss carryforward and statutory differences in the depreciable lives for property and equipment, between the financial statement carrying amounts and tax bases of assets and liabilities give rise to deferred tax assets and liabilities as of December 31, 2005 and 2004, respectively:

|                                      | Year ended<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004 |
|--------------------------------------|------------------------------------|------------------------------------|
|                                      | -----                              | -----                              |
| Deferred tax assets - long-term      |                                    |                                    |
| Net operating loss carryforwards     | \$ 4,080,000                       | \$ 2,669,000                       |
| Deferred tax liabilities - long-term |                                    |                                    |
| Statutory depreciation differences   | (525,000)                          | (690,000)                          |
|                                      | -----                              | -----                              |
|                                      | 3,555,000                          | 1,979,000                          |
| Less valuation allowance             | (3,555,000)                        | (1,979,000)                        |
|                                      | -----                              | -----                              |
| Net Deferred Tax Asset               | \$ -                               | \$ -                               |
|                                      | =====                              | =====                              |

During the years ended December 31, 2005 and 2004, respectively, the valuation allowance increased (decreased) by approximately \$1,576,000 and \$(671,000).

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ITEM 2 - Management's Discussion and Analysis or Plan of Operation

Caution Regarding Forward-Looking Information

Certain statements contained in this Registration Statement including, without limitation, statements containing the words "believes", "anticipates", "expects" and words of similar import, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

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Such factors include, among others, the following: international, national and local general economic and market conditions; demographic changes; the ability of the Company to sustain, manage or forecast its growth; the ability of the Company to successfully make and integrate acquisitions; raw material costs and availability; new product development and introduction; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; the loss of significant customers or suppliers; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; the ability to protect technology; and other factors referenced in this and previous filings.

Given these uncertainties, readers of this Quarterly Report on Form 10-QSB and investors in our equity securities are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

### Restatement issues

The March 31, 2006 financial statements have been restated to account for the derivative liability that was incurred in connection with the common stock conversion features and the warrants issued with certain notes payable (see Notes I and J to the accompanying consolidated financial statements).

The Company accounts for debt with embedded conversion features and warrant issues in accordance with EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The Company determines the fair value to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis.

Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

### General

American Ammunition, Inc. is a holding company with two operating subsidiaries: F&F Equipment, Inc. and Industrial Plating Enterprise Co.

F&F Equipment, Inc. (F&F) was incorporated on October 4, 1983 under the laws of the State of Florida. F&F was formed to engage principally in the "import, export, retail & wholesale of firearms equipment, ammunition & other devices and for the purpose of transacting any and/or all lawful business." F&F

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conducts its business operations under the assumed name of "American Ammunition."

In June 2002, American Ammunition, Inc. formed a wholly owned subsidiary, Industrial Plating Enterprise Co. (IPE), which started production on June 14, 2002. IPE is a fully licensed and approved electrochemical metallization facility with significant capacity for processing our line of projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques.

### Results of Operations

Three months ended March 31, 2006 compared with the three months ended March 31, 2005.

During the three months ended March 31, 2006, we experienced aggregate net revenues of approximately \$710,000, as compared to approximately \$1,170,000 during the first quarter of Calendar 2005. The decline in sales was attributable to our curtailing of production during January 2006 to improve the operating efficiency of our manufacturing equipment and better automate select machines so we can rely upon lower labor requirements in future periods.

In 2004, the Company initiated a direct solicitation program for its "dealer direct" sales program. This endeavor has received a very positive initial response from the qualified retail resellers of the Company's product. We are realizing that the existence of previously announced contracts with various U. S. Governmental agencies and orders from foreign governments are becoming more erratic in their order placements. Accordingly, management is realizing that a consistent demand from the U. S. retail segment will be our best source of consistent sales. Further, we have identified certain production issues which has inhibited the full realization of existing product demands and management believes that the necessary steps are being taken to remedy any production deficiencies.

We experienced costs of goods sold of approximately \$1,378,000 for the three months ended March 31, 2006 as compared to approximately \$1,537,000 for the three months ended March 31, 2005. Through March 31, 2006, and subsequent thereto, we continue to experience negative trends off of our standard production costs for material and labor due to excess labor capacity due to anticipated governmental orders which did not materialize as management was led to believe from the various U. S. Governmental agencies contracting officers. Management remains of the opinion that the production labor force is stable and able to maintain a constant standard of quality in future periods. We experience variable costs in the area of material consumption and direct labor. In the second quarter of 2006, management took drastic steps to reduce excess labor capacity through the elimination of the 2nd shift, which was never able to reach full utilization. This action is not expected to have any adverse impact on our ability to meet our existing and future product demands.

For the three month periods ended March 31, 2006 and 2005, we generated a negative gross profit of approximately \$(668,000), or (94.1%), and approximately \$(366,000), or (31.3%).

We experienced nominal research and development expenses of approximately \$-0- and \$1,700, respectively, during the respective three month periods ended March 31, 2006 and 2005.

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During the first quarters of 2006 and 2005, we expended approximately \$56,000 and \$81,000, respectively, in advertising and marketing expenses, principally in developing and promoting our retail dealer direct program. We anticipate to continue our marketing efforts in this area in future periods; however, the volume and frequency of our expenditures may fluctuate as management allocates available capital to these efforts.

Other general and administrative expenses increased nominally from approximately \$375,000 for the three months ended March 31, 2006 as compared to approximately \$320,000 for the three months ended March 31, 2006. Management is of the opinion that these costs are relatively stable and should not experience significant increases except for inflationary pressures caused principally by increases in energy costs which are affecting all businesses in all sectors of the U. S. economy.

We recognized a net loss of approximately \$(1,221,000) and \$(786,000) for the respective three month periods ended March 31, 2006 and 2005, respectively, or \$(0.29) and \$(0.22) per share. We wish to note that the loss per share includes the effect of our 1 for 20 reverse stock split on January 9, 2006.

### Liquidity And Capital Resources

As of March 31, 2006, December 31, 2005 and March 31, 2005, respectively, we had working capital of approximately \$(1,378,000), \$(885,000) and \$239,000. Our working capital position continues to fluctuate based on collections on our trade accounts receivable and investments from the mandatory exercise of our outstanding warrant related to our convertible debenture. We anticipate that we have sufficient inventory levels to support our order demand and have access to raw material suppliers that will enable us to receive raw materials for future periods. We also note that we have approximately \$975,000 in short-term notes payable to existing shareholders which may or may not be renegotiated, repaid in common stock of the Company or otherwise reclassified prior to their maturity on December 31, 2006. This amount is a contributing factor to our negative working capital position at March 31, 2006 and December 31, 2005.

We have used cash in operating activities of approximately \$(385,000) and \$(392,000) during the quarters ended March 31, 2006 and 2005, respectively. Due to our history of operating losses, our resources for additional working capital are becoming more scarce. Additionally, LaJolla Cove Investors, the holder of our mandatorily convertible debenture and related warrant, is in default on their agreement to provide us with additional working capital. Management is diligently undertaking various steps to assure that the Company can be self-supporting.

We anticipate that our liquidity position will continue to improve as management is of the opinion that, with the current changes to our production capacity, the Company will be in a position to better support all existing orders and accept existing and future inquiries.

During the quarters ended March 31, 2006 and 2005, respectively, we added approximately \$31,000 and \$36,000 in new equipment. Any equipment to be added in future periods is fully dependent upon the Company's cash position, the availability of either new equity or debt capital and the ultimate realization of communicated future product sales demand. However, we may not be able to obtain additional funding or, that such funding, if available, will be obtained on terms favorable to or affordable by us.

## Convertible Debenture

The Company entered into a Securities Purchase Agreement with La Jolla Cove Investors, Inc. ("La Jolla") on October 4, 2002 for the sale of (I) \$250,000 in convertible debentures and (ii) warrants to buy 30,000,000 shares of our common stock. On March 13, 2003 and May 6, 2003, La Jolla advanced an aggregate of \$350,000 to our company which such funding was allocated towards the principal balance of our convertible debentures.

As of March 31, 2006, the outstanding balance on the convertible debenture is approximately \$226,365 and we have approximately 2,263,650 warrants outstanding. A recap of the debenture activity is as follows:

|   | Debenture<br>(in dollars) | Warrant<br>(in shares) |
|---|---------------------------|------------------------|
|   | -----                     | -----                  |
| Initial amount                            | \$ 600,000                | 6,000,000              |
| 2003 redemptions                          | (208,635)                 | (2,086,350)            |
| 2004 redemptions                          | (125,000)                 | (1,250,000)            |
| 2005 redemptions                          | (40,000)                  | (400,000)              |
|   | -----                     | -----                  |
| Balances outstanding<br>at March 31, 2006 | \$ 226,365<br>=====       | 2,263,650<br>=====     |

The debentures bear interest at 8%, mature on June 31 [sic], 2007, and are convertible into the Company's common stock, at the selling stockholder's option. The convertible debentures are convertible into the number of the Company's shares of common stock equal to the principal amount of the debentures being converted multiplied by 11, less the product of the conversion price multiplied by 10 times the dollar amount of the debenture. The conversion price for the convertible debentures is the lesser of (I) \$1.00 or (ii) seventy six percent of the average of the five lowest volume weighted average prices during the twenty (20) trading days prior to the conversion. Accordingly, there is in fact no limit on the number of shares into which the debenture may be converted. However, in the event that our market price is less than \$0.30 per share, the Company will have the option to prepay the debenture at 125% rather than have the debenture converted. In addition, the selling stockholder is obligated to exercise the warrant concurrently with the submission of a conversion notice by the selling stockholder. As of March 31, 2006, the warrant is exercisable into 2,263,650 shares of common stock at an exercise price of \$1.00 per share.

In December 2004, we entered into an addendum to the convertible debenture and warrant whereby the Company agreed to the following:

- \* the discount multiplier was reduced from eighty percent to seventy six percent;
- \* within five business days after this registration statement being declared effective, La Jolla is required to submit a debenture conversion in the amount of \$10,000 and every ten business days thereafter La Jolla shall submit three additional debenture conversion in the amount of \$10,000 each;
- \* within five business days after this registration statement being declared effective, La Jolla shall wire \$400,000 to us as a prepayment towards the exercise of its warrant; and

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- \* immediately following the sale of all shares held by La Jolla in connection with the debenture conversions in the aggregate amount of \$40,000, La Jolla shall wire \$275,000 to us as a prepayment towards the exercise of its warrant and shall submit a debenture conversion in the amount of \$6,250 on the first business day of each month until the debenture is no longer outstanding.

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In May 2005, we entered into an additional addendum to the convertible debenture and warrant whereby the Company agreed to the following:

- \* The Company shall deposit 4,000,000 unregistered shares in the name of LaJolla with the Company's Escrow Agent and, upon confirmation of receipt, LaJolla will wire the Company \$150,000 as an advance on the \$400,000 amount that LaJolla was obligated to fund pursuant to the December 2004 Addendum. In the event that the Company's Registration Statement was not declared effective within nine (9) months of the date of this Addendum, the 4,000,000 shares in escrow will be released to LaJolla and sold by LaJolla pursuant to Rule 144. If LaJolla sells these shares for net sales proceeds of more than \$150,000 (without interest accruing on this amount), the excess over \$150,000 will be refunded to the Company.
- \* The maturity date of the convertible debenture and warrant was extended to June 31, [sic], 2007.
- \* All other terms and conditions remain in full force and effect.

LaJolla has contractually agreed to restrict its ability to convert or exercise its warrants and receive shares of our common stock such that the number of shares of common stock held by them and their affiliates after such conversion or exercise does exceed 4.9% of the then issued and outstanding shares of common stock.

Due to the contractually agreed mandatory conversion of this Debenture, the Company has reflected this transaction in its balance sheet as a "mezzanine" level debt obligation on its balance sheet, between "Total Liabilities" and "Stockholders' Equity". Upon the respective mandatory conversion, the Company will relieve the respective portion of the Debenture and the any related accrued, but unpaid interest, and credit this amount to the respective "common stock" and "additional paid-in capital" accounts in the stockholder's equity section for the par value and excess amount over the par value of the respective shares issued.

As the warrant is non-detachable from the Debenture and requires simultaneous exercise upon conversion of the Debenture, no value was assigned to the issued warrant. Upon exercise of the warrant, the Company will record the issuance of the underlying shares as a new issuance of common stock on the date of each respective exercise.

On various dates through December 31, 2003, the Debenture Holder elected to convert an aggregate \$208,635, through 24 separate transactions, in outstanding Debenture principal into restricted, unregistered common stock. This election caused the Company to issue 4,561,753 shares of restricted, unregistered common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 2,086,350 shares of the Company's restricted, unregistered common stock

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for gross proceeds of \$2,086,350.

On various dates between January 1, 2004 and December 31, 2004, the Debenture Holder elected to convert an aggregate \$125,000, through 6 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 4,150,000 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 1,250,000 shares of the Company's common stock for gross proceeds of \$1,250,000. As of December 31, 2004, an aggregate of 1,000,000 shares of the Company's common stock have been issued by the Company and are being held in escrow by the Company's counsel pending receipt of the final \$175,000 from the Debenture Holder. As of March 31, 2006, this amount remains unpaid.

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On various dates between June 28, 2005 and August 10, 2005, the Debenture Holder elected to convert an aggregate \$40,000, through 4 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 5,872,048 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 400,000 shares of the Company's common stock for gross proceeds of \$400,000.

LaJolla is in default on their contractual agreements to redeem the outstanding warrant(s) and convert the outstanding debenture as of March 31, 2006.

### ITEM 3 - Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act), for the quarter ended March 31, 2006. As of the end of the period covered by this report, management, including the chief executive officer and chief financial officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based upon and as of the date of that evaluation, our CEO and CFO concluded that the disclosure controls and procedures were effective

#### (b) Changes in Internal Controls

There were no significant changes (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal controls over financial reporting that occurred during the quarter ended March 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### Part II - Other Information



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### ITEM 1 - Legal Proceedings

The Company may become involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse impact either individually or in the aggregate on consolidated results of operations, financial position or cash flows of the Company.

### ITEM 2 - Unregistered Sales of Equity Securities and Use of Proceeds

In February 2006, the Company issued approximately 41,666 shares of unregistered, restricted common stock to Paul Goebel, the Company's Director of Domestic Sales, as an employee bonus. These shares were valued at approximately \$17,500, which approximated the market value of the shares on the transaction date. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In February 2006, the Company issued approximately 226,065 shares of restricted, unregistered common stock, valued at approximately \$18,325, to National Business Investors, Inc., an existing shareholder, as for payment of accrued interest associated with approximately \$875,000 short-term working

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capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

### Series E 8% Convertible Preferred Stock

On March 1, 2006, the Company issued a Private Placement Memorandum offering up to 200,000 shares of 8% Convertible Preferred Stock at an offering price of \$5.00 per share on a "best efforts" basis through an unrelated placement agent.

The Series E 8% Convertible Preferred Stock provides for cumulative dividends at the rate of 8% per year, payable quarterly, 50% in cash and 50% in shares or 100% in cash at the Company's election. In the event the Company elects to pay such dividends in shares of the Company's Common Stock, the number of shares to be issued shall be based on the average of the closing prices of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the Company's Common Stock is then traded) for the 10 consecutive trading days preceding the record date for each such dividend, with such record date being the 14th day preceding the end of each calendar quarter.

Each share of Series E Convertible Preferred Stock shall be convertible into shares of the Company's Common Stock at any time after March 1, 2007. The number of shares to be issued on a conversion shall be based on 80% of the average closing price of the Common Stock of the Company; as reported on the NASDAQ OTC Bulletin Board (or such other market on which such stock is traded) for ten (!) consecutive trading days preceding the date the Company received notice of such conversion. Subject to certain restrictions, the Series E 8% Convertible Preferred Stock shall automatically convert into shares of the Company's Common Stock upon any of the following events: (I) the sale by the

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Company of all or substantially all of its assets; (ii) the consummation of a merger or a consolidation in which the Company is not the survivor; or (iii) the sale or exchange of all or substantially all of the outstanding shares of the Company's common stock (including by way of merger, consolidation, or other similar action).

In the event of the liquidation, dissolution or winding up of the Company, the holders of Series E Convertible Preferred Stock shall have a liquidation preference over holders of common stock and shares junior to the Series E 8% Convertible Preferred Stock equal to \$5.50 per share. Additionally, the Company shall not impose or allow any additional liens on its existing fixed assets in excess of \$1,000,000; provided that at such time as total gross proceeds from the offering equal or exceed \$2,000,000, the Company shall satisfy such existing liens on its existing fixed assets and shall not impose or allow any additional liens on its existing fixed assets unless subordinated to the interest of the Series E 8% Convertible Preferred Stock, with such preference on the fixed assets equal to the fixed asset value, as determined in accordance with the United States Generally Accepted Accounting Principles ("GAAP"), of 150% of the stated value of the aggregate of the outstanding shares of Series E Convertible Preferred Stock except for fixed assets of the Company that were otherwise purchased pursuant to a security interest.

The Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the Company, for cash in the amount of \$5.50 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate, at any time after March 1, 2007, or in the event the closing sale price of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the

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Company's Common Stock is then traded), is greater than or equal to \$7.00 after March 1, 2007 for any consecutive five trading days. In addition, the Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the holder, at any time for shares of the Company's Common Stock in accordance with the Conversion Rate. At any time after March 1, 2007, at the option of the holder, the Series E 8% Convertible Preferred Stock shall be redeemable for cash in the amount of \$5.10 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate. After such date, if redemption is for cash, shares will be redeemed at the rate of 1/10 of such aggregate shares per quarterly period for any 10 consecutive quarters commencing after March 1, 2007. Any redemption by either the Company or the holder shall be subject to 15 days written notice.

The Company warrants and agrees that if, at any time within the period commencing on the date of the final closing of the Offering and expiring on the 5th anniversary of the date thereof, the Company should file a registration statement with the SEC under the Securities Act (other than in connection with a merger or other business combination transaction or pursuant to Form S-8), it will give written notice at least 30 calendar days prior to the filing of each such registration statement to the holders of the Series E 8% Convertible Preferred Stock and the holders of the shares of the Common Stock issued upon the conversion or redemption of the shares of Series E Convertible Preferred Stock, or their permitted assigns (Holders) of its intention to do so. If the Holders notify the Company within 30 calendar days after receipt of any such notice of its or their desire to include any such shares of Common Stock issued or issuable upon the conversion or redemption of the Series E 8% Convertible

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Preferred Stock in such proposed registration statement, the Company shall use its "best efforts" to have any such shares of Common Stock is issued or issuable upon the conversion or redemption of the Series E 8% Convertible Preferred Stock registered under such registration statement. Notwithstanding the foregoing, the Company shall have the right at any time after it shall have given written notice (irrespective of whether a written request for inclusion of any such securities shall have been made) to elect not to file any such proposed registration statement, or to withdraw the same after the filing but prior to the effective date thereof. If the managing underwriter of an offering to which the above "piggyback registration rights" apply, in good faith and for valid business reasons, objects to such rights, such objection shall preclude such inclusion. All expenses incurred by the Company in registration of the shares of Common Stock issued or issuable upon the conversion or redemption of The Series E 8% Convertible Preferred Stock, including with out limitation all registration and filing fees, listing fees, printing expenses, fees and disbursements of all independent accounts, or counsel for the Company and the expense of any special audits incident to or required by any such registration and the expenses of complying with the securities or blue sky laws of any jurisdiction shall be paid by the Company.

The Company has agreed to pay the Placement Agent a cash commission equal to 10% of the aggregate Purchase Price of the shares of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Fee). The Company shall also pay the Placement Agent reasonable expenses associated with the Offering, which expenses shall not exceed \$50,000 (Expense Allowance). In addition, the Company shall issue to the Placement Agent 500 warrants for each \$50,000 of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Warrants), each warrant entitling the holder to purchase 1 share of the Company's Common Stock at an exercise price of \$0.90 per share exercisable at any time for a period of 3 years from date of issuance.

Upon completion of the Maximum Offering, the Company will receive net proceeds of approximately \$900,000.00. The Company intends to use the net proceeds for potential acquisitions, working capital, general corporate purposes and repayment of outstanding debt.

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The Company and the Placement Agent shall have discretion to increase the Maximum Offering to \$2,000,000.00, without notice to investors..

On March 27, 2006, the Company has sold 50,000 shares in a separate transaction under this Private Placement Memorandum and has received additional gross sales proceeds of \$250,000 and paid \$25,000 to the Placement Agent for the 10% fee due on this transaction. The Company used the \$250,000 in proceeds to support it's operations during the 1st quarter of Calendar 2006 as shown on the accompanying statement of cash flows.

ITEM 3 - Defaults on Senior Securities

None

ITEM 4 - Submission of Matters to a Vote of Security Holders

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None

ITEM 5 - Other Information

None

ITEM 6 - Exhibits and Reports on Form 8-K

(a) The following sets forth those exhibits filed pursuant to Item 601 of Regulation S-K:

| Exhibit | Descriptions   |
|---------|--|
| 31.1    | Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002. |
| 32.1    | Certification pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |

(b) The following sets forth the Company's reports on Form 8-K that have been filed during the quarter for which this report is filed:

None.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

American Ammunition, Inc.

Dated: October 19, 2007

/s/ Andres F. Fernandez

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Andres F. Fernandez  
President, Chief Executive Officer  
Chief Financial Officer and Director